

Interest Rates on Advances – Prime Lending Rate and Spreads

DBOD. No. Dir. BC.103A/13.03.00/2002-03

April 30, 2003

All Scheduled Commercial Banks
(**excluding** RRBs and LABs)

Dear Sir

Please refer to paragraph 2 of our Master Circular DBOD. No. Dir. BC. 11/ 13.03.00/2002-03 dated July 30, 2002 on Prime Lending Rate (PLR).

2. In this connection, a reference is invited to paragraphs 81, 82 & 83 of the statement on 'Monetary and Credit Policy' for the year 2003-04 enclosed with Governor's letter MPD No. BC. 230/07.01.279/2002-03 dated April 29, 2003. At present, commercial banks decide the lending rates to different borrowers (with credit limits of over Rs. 2 lakh) subject to the announcement of PLR as approved by their Boards. In order to enhance transparency in banks' pricing of their loan products as also to ensure that the PLR truly reflects the actual costs, banks are advised to consider the following suggestions for determination of their benchmark PLR:

- (a) Banks should take into account their (i) actual cost of funds, (ii) operating expenses and (iii) a minimum margin to cover regulatory requirement of provisioning/capital charge and profit margin, while arriving at the benchmark PLR. Banks should announce a benchmark PLR with the approval of their Boards.
- (b) As is already the case, the benchmark PLR would continue to be the ceiling rate for credit limit up to Rs.2 lakh.
- (c) Since all other lending rates can be determined with reference to the benchmark PLR arrived at as above by taking into account term premia and/or risk premia, the system of tenor-linked PLR deserves to be discontinued. These premia can be factored in the spread over or below the PLR.

As regards the effective date for discontinuation of the tenor-linked PLR the same will be further discussed with banks and a decision will be announced separately in due course.

3. Banks are also advised in the interest of the customer protection and to have greater degree of transparency in regard to actual interest rates charged to borrowers, to continue to provide information on maximum and minimum interest rates charged together with the benchmark PLR.

4. The system of determination of benchmark PLR by banks and the actual prevailing spreads around the benchmark PLR is proposed to be reviewed in September 2003. Banks may, therefore, advise to the Reserve Bank, the action taken on the above suggestions as early as possible.

Please acknowledge receipt.

Yours faithfully

(M. R. Srinivasan)
Chief General Manager-in-Charge